

Message Text

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ACTION EUR-12

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P R 231635Z JUN 75

FM AMEMBASSY ROME

TO SECSTATE WASHDC PRIORITY 1710

INFO USMISSION EC BRUSSELS

AMCONSUL MILAN

AMCONSUL NAPLES

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PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: EFIN, IT

SUBJECT: CURRENT POLITICAL/ECONOMIC VIEWS OF MILANESE BANKING
COMMUNITY

REF: (A) ROME 17582, DECEMBER 20, 1974

(B) ROME 8753, JUNE 18, 1975

1. SUMMARY. DURING SEMI-ANNUAL VISIT (REF A) TO MILAN
BANKING COMMUNITY JUNE 18-20 BY TREASATT AND MILAN CONSULATE
OFFICER, BANKERS WERE PREOCCUPIED WITH SHIFT TO LEFT OF
ITALIAN ELECTORATE SHOWN BY JUNE 15-16 ADMINISTRATIVE
ELECTIONS. STOCK MARKET AND EXCHANGE MARKET REACTIONS WERE
WORRISOME BUT LESS BAD THAN MIGHT HAVE BEEN EXPECTED.
BANKERS THOUGHT THAT LEFTWARD SHIFT COULD HURT DOMESTIC
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INVESTMENT AND ITALY'S FOREIGN CREDITWORTHINESS. ECONOMIC

UPTURN WAS FORESEEN LATE IN 1975 OR EARLY IN 1976. EXPORT PROSPECTS IN SHORT RUN WERE VIEWED AS RELATIVELY GOOD. HOWEVER, ITALIAN MEDIUM-TERM BALANCE OF PAYMENTS EQUILIBRIUM APPEARED RATHER UNCERTAIN. END SUMMARY.

2. POLITICAL ASSESSMENT. MILANESE BANKERS WERE GENERALLY PREOCCUPIED WITH ASSESSMENT OF SHIFT TO LEFT SHOWN IN ADMINISTRATIVE ELECTIONS. THERE WAS GENERAL AGREEMENT THAT LARGE INCREASE IN COMMUNIST PARTY (PCI) VOTE CONTAINED SUBSTANTIAL PROTEST VOTE WHICH MIGHT, OR MIGHT NOT, BE REVERSIBLE. BANKERS INTERPRETED THIS VOTE AS CLEAR WARNING TO CHRISTIAN DEMOCRATIC PARTY (DC) OF IMPATIENCE WITH CORRUPT AND INEFFICIENT GOVERNMENT WHICH HAD EVOLVED DURING DC'S LONG YEARS IN POWER. WHETHER VOTE WAS REVERSIBLE DEPENDED ON ABILITY OF DC TO REFORM ITSELF, ABOUT WHICH THERE WAS CONSIDERABLE DOUBT. ONE RANKING ITALIAN EMPLOYEE OF LARGE AMERICAN BANK WAS PARTICULARLY CRITICAL OF SPEECH BY DC SECRETARY FANFANI AT DC DIRECTORATE MEETING JUNE 19, DURING WHICH FANFANI SEEMED TO BLAME DC DEFEAT ON SOCIALISTS (PSI) AND ON ITALIAN PRESS.

3. AS TO IMMEDIATE EFFECT ON ITALIAN FINANCIAL MARKETS OF JUNE 15-16 ELECTIONS, THERE HAD BEEN DROP OF NEARLY 8 PERCENT IN MILAN STOCK MARKET ON JUNE 17. BRIEF RECOVERY OF OVER 2 PERCENT ON JUNE 18 WAS FOLLOWED BY FURTHER DECLINE, SO THAT MARKET ON JUNE 20 WAS DOWN ALMOST 9 PERCENT FROM PREVIOUS FRIDAY (I.E., BEFORE ELECTIONS). EXCHANGE MARKET ALSO REACTED ADVERSELY, ALTHOUGH LESS THAN MIGHT HAVE BEEN EXPECTED. SPOT EXCHANGE RATE CHANGED VERY LITTLE, ALTHOUGH THERE WAS FAIRLY HEAVY SUPPORT BY BANK OF ITALY (SEE REF B). LIRA IN FORWARD MARKET, AND PARTICULARLY IN BLACK MARKET, ALSO WEAKENED SLIGHTLY, SO THAT ON JUNE 20 THREE-MONTH FORWARD LIRA WAS UP ABOUT 1 PERCENT COMPARED TO JUNE 13 AND BLACK MARKET RATE WAS UP ALMOST 4 PERCENT. ALL BANKERS AGREED THAT, OVER LONGER RUN, ELECTIONS WOULD ALSO HAVE ADVERSE EFFECT ON DOMESTIC INVESTMENT PLANS OF MEDIUM AND SMALL BUSINESS.

4. ECONOMIC RECOVERY. BANKERS SAW LITTLE EVIDENCE FROM SHORT-TERM CREDIT DEMAND AT COMMERCIAL BANKS OF ECONOMIC LIMITED OFFICIAL USE

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UPTURN, IN SPITE OF INCREASED AVAILABILITY OF FUNDS AND SOMEWHAT REDUCED INTEREST RATES. (SOME BANKERS REPORTED SHAVING OF RECENTLY-REDUCED 14 PERCENT PRIME RATE.) ON OTHER HAND, RECENT SUCCESS OF SOME LARGE MEDIUM-TERM BOND ISSUES WAS CITED BY ONE BANKER AS EVIDENCE OF EVENTUAL RECOVERY IN INVESTMENT DEMAND, ALTHOUGH PART OF PROCEEDS OF SUCH ISSUES MIGHT BE FOR CONSOLIDATION OF SHORT-TERM DEBT. MOST BANKERS THOUGHT THAT CURRENT INVENTORY ADJUSTMENT, WHICH HAS BEEN

DEPRESSING FACTOR ON PRODUCTION AND IMPORTS, MIGHT LAST FOR ANOTHER MONTH OR TWO. ONE OR TWO BANKERS THOUGHT THAT OECD AND OTHER FORECASTS OF 10 PERCENT OR MORE DROP IN FIXED INVESTMENT IN 1975 WERE REALISTIC. SEVERAL THOUGHT THAT INCREASE IN FIXED INVESTMENT WHICH HAD TAKEN PLACE IN 1973-1974 WAS MAINLY FOR PLANT MODERNIZATION RATHER THAN FOR EXPANSION OF PRODUCTIVE CAPACITY. THEY CONCLUDED THAT THERE WAS DANGER THAT ECONOMIC RECOVERY WOULD RATHER PROMPTLY ENCOUNTER PRODUCTION BOTTLENECKS. A MINORITY VIEW BY ONE LARGE ITALIAN BANK RE MEDIUM-TERM INVESTMENT PROSPECTS WAS BELIEF THAT RESTRUCTURING OF ITALIAN ECONOMY FOLLOWING OIL PRICE RISE WOULD CREATE INVESTMENT BOOM IN ENERGY AND IN EXPORT SECTORS WHICH WOULD CONTRIBUTE TO RECOVERY FROM PRESENT RECESSION AND ASSURE FAIRLY FAST RATE OF GROWTH THEREAFTER.

5. BANKERS WERE ABOUT EVENLY DIVIDED BETWEEN THOSE WHO COULD FORESEE BEGINNING OF ECONOMIC RECOVERY BEFORE END-1975 AND THOSE WHO THOUGHT RECOVERY WOULD NOT BEGIN UNTIL FIRST HALF OF 1976. SOME CONSIDERED THAT, EVEN IF THERE WERE TENDENCY TOWARD RECOVERY BEFORE END-YEAR, LABOR NEGOTIATIONS IN IMPORTANT METALMECHANICAL SECTOR COULD WELL RESULT IN STRIKES WHICH WOULD DELAY RECOVERY INTO 1976

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TO SECSTATE WASHDC PRIORITY 1654

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PASS TREASURY AND FRB

6. BALANCE OF PAYMENTS PROSPECTS. THERE WAS GENERAL VIEW THAT, IN SHORT RUN, ITALY'S EXPORT PRICES ARE COMPETITIVE AND THAT DOMESTIC RECESSION IS FORCING ITALIAN EXPORTERS TO SHIFT THEIR SALES EFFORTS ABROAD. OVER MEDIUM-TERM, HOWEVER, THERE WAS CONSIDERABLE DISAGREEMENT AS TO WHETHER ITALY WOULD BE ABLE TO RE-ESTABLISH AND MAINTAIN BALANCE OF PAYMENTS EQUILIBRIUM AT NEW LEVEL OF COMMODITY PRICES. PREVALENT PESSIMISTIC VIEW SEEMED TO BE THAT RECENT EXCESSIVE INCREASES IN LABOR COSTS WOULD CONTINUE AND THAT FLOATING EXCHANGE RATE COULD ONLY PARTIALLY OFFSET HIGHER RATE OF PRICE INCREASES IN ITALY THAN ABROAD, BECAUSE OF INFLATIONARY FEEDBACK FROM DEPRECIATION OF LIRA. SOME BANKERS THOUGHT THAT MEDIUM AND SMALL BUSINESSES, WHICH HAVE BEEN PARTICULARLY FLEXIBLE PART OF ITALIAN EXPORT SECTOR IN RECENT YEARS, WOULD NO LONGER HAVE PROFIT MARGINS AVAILABLE TO PERMIT THEM TO COMPETE,

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SINCE THEIR ABILITY TO ESCAPE FULL COMPLIANCE WITH TAX LAWS AND LABOR CONTRACT TERMS HAS BEEN SIGNIFICANTLY REDUCED. SOME BANKERS ALSO PREDICTED THAT INADEQUACIES IN ITALY'S EXPORT CREDIT FINANCING ABILITIES WOULD LIMIT ITALIAN PENETRATION OF NEW MARKETS IN OPEC COUNTRIES AND OTHER LDC'S WHICH HAVE BENEFITTED OR MAY BENEFIT FROM FUTURE COMMODITY BOOM.

7. MORE OPTIMISTIC MINORITY VIEW WAS THAT RECOVERY IN ITALIAN TERMS OF TRADE WOULD CONTINUE THROUGH INCREASE IN ITALIAN EXPORT PRICES, WHICH WOULD NOT RISE SIGNIFICANTLY MORE THAN THOSE OF OTHER INDUSTRIAL COUNTRIES. WHILE LABOR COSTS WOULD INCREASE, EXCHANGE RATE MOVEMENT WOULD BE SUFFICIENT TO COMPENSATE. IN PARTICULAR, ITALIAN EXPORTS WOULD DO VERY WELL IN NEW MARKETS IN OPEC COUNTRIES AND IN LDC COMMODITY EXPORTERS. THESE COUNTRIES WOULD BE IMPORTING RELATIVELY UNSOPHISTICATED CAPITAL GOODS AND SOME CONSUMER GOODS IN WHICH ITALY HAS PRICE, DESIGN AND DELIVERY ADVANTAGES. ALSO, MINORITY VIEW HELD THAT INCREASED ATTENTION TO ITALIAN AGRICULTURAL SECTOR COULD REDUCE UNNECESSARILY LARGE IMPORTED FOOD BILL.

8. FOREIGN CREDITWORTHINESS. AMONG REPRESENTATIVES OF AMERICAN BANKS, THERE WAS EVIDENCE OF SOME GRADUAL IMPROVEMENT IN RECENT MONTHS IN THEIR EVALUATION OF ITALY AS A CREDIT

RISK. THIS WAS PARTICULARLY TRUE FOR LARGER BANKS AND FOR SHORT-TERM CREDIT, ESPECIALLY IF LATTER WERE RELATED TO ITALIAN EXPORTS OR TO RPRIME ITALIAN CLIENTS. AS TO MEDIUM-TERM EURCREDITS, THERE HAD BEEN SOME BELIEF BEFORE ELECTIONS THAT BY LATE 1975 LIMITED REFINANCING OF MATURITIES OR LIMITED NEW LOANS MIGHT HAVE BEEN POSSIBLE. HOWEVER, WORSENEDED POLITICAL SITUATION COULD HAVE ADVERSE IMPACT, AT LEAST AMONG SMALLER BANKS.

9. SEVERAL AMERICAN BANKERS REFERRED TO BELOW FIRST CATEGORY RATING OF THEIR ITALIAN PORTFOLIOS BY U.S. NATIONAL BANK EXAMINERS. THEY DID NOT SEEM TO BE COMPLETELY INFORMED ABOUT POSITION TAKEN BY EXAMINERS WITH THEIR HEAD OFFICES, BUT GENERALLY HAD IMPRESSION THAT ITALY'S CREDIT RATING HAD NOT BEEN RAISED, EXCEPT PERHAPS THAT SOME DISTINCTION WAS BEING MADE BETWEEN IMPROVED PROSPECTS FOR SHORT-TERM CREDIT LIMITED OFFICIAL USE

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